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Memorandum for:

The attached country summaries were included in a briefing package for Vice President Bush prior to his trip to Western Europe. The summaries were updates/revisions of papers originally prepared for Secretary of State Shultz's December trip.

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Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

France: The Political and Economic Scene

Summary

1982 has been a year of disappointment and frustration for President Francois Mitterrand. The ambitious goals and resolute optimism in evidence when Mitterrand took office in May 1981 have given way to austerity and dogged determination. Mitterrand and Prime Minister Pierre Mauroy are now trying to undo the damage caused by economic miscalculations while striving to minimize their political and foreign policy losses. [REDACTED]

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Political Situation

Nationwide elections for mayoral and city council posts in March will provide a measure of the political fallout. Municipal elections are always important for the patronage involved. The March round takes on an added dimension because a decentralization program has given increased powers to local authorities. In addition, there is general agreement that the elections will constitute a referendum on the Mitterrand government. [REDACTED]

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The government's current position is not comfortable. The recession and the austerity program have already upset large numbers of voters, and policy gyrations have sparked criticism from nearly all of France's powerful interest groups, even from the Socialist Party and the trade union federations. The Gaullist Rally for the Republic (RPR) and the centrist Union for French Democracy (UDF) rebounded sharply in regional assembly elections last spring from their unexpectedly severe defeat in 1981. Cooperation between the two major opposition parties was aided by former President Giscard's eclipse, which left Gaullist Jacques Chirac the de facto leader of the opposition. Although Giscard's cautious return to national politics could rekindle his bitter rivalry with Chirac, the centrists and the Gaullists are likely to present a fairly united front in March. All this adds up to probable losses at the polls for the left. [REDACTED]

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A substantial leftist setback would increase chances for a cabinet reshuffle and an open crisis in the uneasy Socialist-Communist coalition. Premier Mauroy's position appears particularly precarious. He has been given explicit responsibility for both the austerity program and the election campaign. He is not likely to weather both storms well enough to remain in office. If he goes, another Socialist moderate would likely be tapped as the successor. [REDACTED]

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We believe the Communist decline is continuing. A combination of further election losses in March and expected new opposition to the Socialist austerity program make a break probable, although the exact timing of a break is difficult to predict. In opposition, the PCF would be troublesome, particularly on the labor front, but Mitterrand and the Socialists probably would not be seriously threatened. Mitterrand will have to decide, however, whether to rely solely on the Socialist majority in the National Assembly or to try to bring some centrists and left-wing Gaullists into the government.

[REDACTED] In recent interviews, Mitterrand has suggested that he is prepared to sacrifice short-term political goals to lay the groundwork for an economic recovery which Socialist candidates can point to in the parliamentary elections in 1986. [REDACTED]

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Economic Outlook

Mitterrand's problems stem from his decision to adopt a stimulation program at a time when France's principal trading partners were restraining economic activity and fighting inflation. When the expected general recovery did not materialize, France was left with mounting trade deficits and a greatly weakened franc. Moreover, income redistribution measures and high inflation severely aggravated the already weak financial positions of many French firms, leaving them less able to invest and to win back markets at home and abroad. [REDACTED]

The June devaluation forced Mitterrand to rein in. A wage/price freeze was instituted to signal the government's determination to cut inflation and to restore balance to the public and external accounts. In addition, making up for earlier redistributive excesses, the government is now giving priority to rebuilding corporate balance sheets. The freeze has been replaced by a phased withdrawal through 1983 that, if maintained, will reduce real wages appreciably for most workers. [REDACTED]

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Even if the government's resolve holds, it will take time for the measures to work. Real growth was little better than one percent in 1982 and probably will be even less this year. The rise in unemployment slowed somewhat last year, but the period of reduced growth now in prospect may again bring rapid deterioration in 1983, despite the government's efforts to prop up the job market. The freeze brought the government's goal of limiting consumer price increases in 1982 to 10% within reach, but further progress will depend on Mitterrand's firmness in maintaining wage guidelines during the phasing-out period. The trade balance has yet to show any improvement from the June devaluation, and the 1982 deficit was on the order of \$13 billion. Exports should benefit this year, however, and slumping domestic consumption -- coupled with the impact of recently implemented protectionist measures -- should produce a sizable decline in imports. [REDACTED]

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-2-
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Foreign Policy Priorities

The stumbling economy and uncertain domestic political scene have affected French relations with other nations. The Gaullist tendency to circle the wagons -- never far beneath the surface -- has shown renewed vigor under the Socialists. Recent French actions to reduce imports, which have been accompanied by much bellicose rhetoric, are a good example. The reaction to the President's decision to remove the sanctions is another. US economic policies remain a ready scapegoat for the government's problems. The need to reassure supporters disillusioned by austerity may also prompt foreign policy actions designed to demonstrate the government's "socialist" credentials.

Mitterrand's difficulties cut even deeper. Defense spending is being curtailed in some non-nuclear categories, affecting France's own capabilities and diminishing its ability to press other Europeans for a stronger defense effort. Budgetary limitations also make it more difficult for Paris to pursue its interests in areas outside Europe, such as Africa. [REDACTED]

These problems are not likely to change the basic lines of Mitterrand's foreign policy, which will remain broadly compatible with our own. But their repercussions have not made the French any easier to deal with. [REDACTED]

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-3-
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DIRECTORATE OF INTELLIGENCE

Italy: The Political and Economic SceneSummary

Socialist maneuvering to secure the prime minister's post has dominated the political scene for the last 18 months. With Socialist ambitions pitting them against the two largest political parties (Christian Democrat and Communist), the Italian talent for compromise has been severely taxed. Sparring over fiscal policy has been the most visible sign of friction within the coalitions that have included both the Socialists and Christian Democrats. On the other hand, the two Spadolini governments (June 1981-November 1982) had a fairly impressive record on terrorism and foreign policy and the new Fanfani government shows signs of continuing along this vein. We believe this mix of failure in the economic policymaking arena and relative success elsewhere will probably persist, at least until national elections are held.

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Political Situation

The Socialists (PSI) hope that the next parliamentary election will bring them healthy gains. While they would like national elections to be held before the scheduled date, they have had to be careful not to push too hard for fear of provoking collaboration between the Christian Democrats (DC) and the Communists (PCI). This would relegate the PSI to the sidelines. The May 1982 selection of Ciriaco DeMita to the DC's top post accentuated this fear. DeMita is more disposed to cooperation with the PCI than his predecessor. Publicly, however, he insists that his party does not view the Communists as acceptable coalition partners at this time.

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An election -- early or on schedule in June 1984 -- is unlikely to alter the balance of power enough to end coalition instability and frequent policy immobilism that has plagued the country in the postwar era. Even if Craxi's party increases its electoral strength from roughly 10 percent (in 1979) to the hoped-for 15 percent, the Socialists will still be dwarfed by the Christian Democrats (38 percent in 1979) and the Communists (30 percent). Unless united with the other lay parties by means of a programmatic accord, the Socialists would be unable to challenge DC hegemony. No such accord now appears on the horizon. Thus, a Socialist-led government would depend on DC -- or perhaps PCI -- goodwill for its longevity and success.

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Institutional reform is being touted as another way to improve the government's policymaking capabilities. But here again, change will not come quickly. While all the parties are giving lip service to various reform proposals, only the Socialists seem serious about securing these reforms. Frequently mentioned reforms include: streamlining the cabinet, increasing the prime minister's power, and more strictly limiting parliamentary recourse to secret votes. ☐ 25X1

Economic Outlook

All the major parties seem convinced that the next election will be won or lost over economic policy. This conviction led to a nasty and time-consuming budget battle last year, when early elections were also a possibility. The same battle lines have already been drawn over 1983 fiscal policy -- and contributed to the resignation of the second Spadolini government on 13 November. The Christian Democrats continue to press for austerity in the form of tax hikes and limited welfare spending cuts, while the Socialists insist that jobs and economic growth should not be sacrificed to austerity. ☐ 25X1

The new Fanfani government seems to be faring no better than its predecessor on the economic front. Fanfani has been forced steadily by coalition considerations to retreat from his initial proposals -- a softened version of the Spadolini program. The coalition presently faces a serious split over proposed property tax hikes. The Social Democrats and Liberals, junior partners in the government, have threatened to oppose the measures if they are brought before parliament. The Cabinet will meet to consider tax questions again this Friday. A failure by Fanfani to come up with an acceptable compromise could result in still another government "crisis." ☐ 25X1

Late last year former Budget Minister La Malfa speculated that if pre-election jitters prevented the adoption of austerity measures Italy's budget deficit could top 17 percent of GDP in 1983. Last year's deficit is likely to be around 15 percent of GDP. Journalists at home and abroad have questioned whether even Italy's extraordinarily elastic system can swallow this increase. We believe it can, barring another external economic shock to the system. Our confidence stems primarily from the Bank of Italy's well-deserved reputation for keeping a close watch on the country's external finances. ☐ 25X1

Although later and slower than other industrialized countries, Italy is now adjusting to the oil price hikes of 1979-80. Tight monetary policy is helping narrow the current account deficit, which hit a high of \$9.8 billion in 1980. Inflation declined throughout most of 1982 but began to climb again in late summer. As elsewhere, adjustment to higher oil prices has taken a toll on jobs and growth. We believe the evolution of the economy in 1983 will be similar to last year's record. The dim prospects are conditioned more by the inhospitable international setting than by domestic policy choices. ☐

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Foreign Policy Priorities

New activism in Italian foreign policy contrasts sharply with inertia in economic policy. Involvement in the Lebanon multinational force, government willingness to deploy GLCMs at Comiso, and stepped-up foreign aid expenditures all attest to the new activism. We suspect a variety of factors accounts for this changed attitude to foreign affairs: desire to be included in high-level Atlantic Summits, fading memories of overseas misadventures during the Fascist era, concerns about the health of the Atlantic alliance, a DC-PSI rivalry for Washington's affection, the desire of the major parties to enhance their reputation as champions of Third World causes, and the de facto acquiescence of the Communists to these foreign policy initiatives.

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Next 2 Page(s) In Document Denied

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The Netherlands: The Political and Economic SceneSummary

25X1 The new center-right Christian Democratic-Liberal coalition government has a solid majority in parliament and an agreed program. Nevertheless, Prime Minister Ruud Lubbers may find it difficult to take decisive steps on the two most troublesome issues facing the government -- the stagnant economy and INF basing. In both instances the obstacle is likely to be the left wing of his own party.

[redacted]

Political Situation

25X1 The new government is likely to remain cohesive in the short run, but it may be unable to finish its four-year term. Lubbers, who became Christian Democratic Appeal leader in October after former Prime Minister Van Agt stepped down, does not have the prestige that helped his predecessor over rough spots. Moreover, he is to the left of Van Agt and is thus not completely trusted by his Liberal coalition partners. The Embassy describes him as a "bridge-builder" who seeks accommodation -- a leadership style that hampers action on contentious issues, especially in the already complex web of Dutch politics.

[redacted]

The coalition will undoubtedly face its biggest challenge when it tries to implement its program of deep budget cuts, especially in the social welfare area. The INF issue is also likely to continue to be unsettling for the government. Pressure from the vocal Christian Democratic left wing is likely to force the government to move more slowly than it would prefer on both issues.

[redacted]

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Economic Outlook

The Dutch economy continued its most serious postwar recession through the first half of 1982. Real GNP showed no growth in 1982 after a 1.1-percent decline in 1981. Unemployment has grown from 5.8 percent of the labor force in 1980 to over 12 percent at yearend 1982. Consumer demand, investment, and exports have remained weak after sharp downturns in 1981. Imports also fell in response to destocking and weakening domestic demand. On the positive

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side, moderating inflation, a growing external surplus, and the strength of the Dutch guilder as an international currency are laying the groundwork for an export-led recovery in 1983. []

The new government may be able to cut the budget deficit and put business on a more profitable footing, but it remains far from certain that it will be able to reach a national consensus on the belt-tightening and restructuring needed for sustained economic growth. It faces a deficit equal to 10.5 percent of net national income, far above the 6.5-percent official target and last year's 8.3 percent. Attempts by the left wing of the Christian Democrat coalition members and the trade unions to retain social welfare gains made by lower income groups will strain the coalition and prevent real progress. Social welfare expenditures in the Netherlands now account for 25 percent of total government spending. []

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The current account moved strongly into surplus in 1981 and showed some further gains in 1982 despite reduced earnings on gas sales. Exports have been helped by lower wage settlements and a decline in the value of Holland's currency relative to that of West Germany -- a major trading partner. Imports remained weak because of measures limiting income and restraints on government spending. Continued improvements in the terms of trade helped the current account surplus reach about \$6 billion in 1982. We expect the surplus to recede gradually this year, perhaps to around \$3 billion, as the economy -- and import demand -- picks up. []

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Foreign Policy Priorities

Staunch Liberal support for INF deployment places the new coalition in a better position than its predecessor to accept the missiles, but Lubbers personally is not as dedicated to deployment as was Van Agt. The cabinet will probably try to avoid controversy by remaining at the "passive preparation" stage entailing studies of possible INF sites and by delaying a decision on deployment, at least until a ten-year defense study is issued in September. Moreover, Dutch officials might propose that they should drop several short-range NATO nuclear roles to ease the way for a positive deployment decision if the Geneva INF talks fail. In any case, the Liberals, who broke precedent by allowing the Christian Democrats to occupy both the Foreign and Defense Ministries, will let their partners set the pace on this issue since it is they who must reach a consensus. []

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On other issues such as Central America, the new government, including Foreign Minister Hans van Den Broek, will probably be more sympathetic to US concerns and policies than was its predecessor. []

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Belgium: The Political and Economic Scene

Summary

Prime Minister Martens' year-old Social Christian-Liberal coalition (his fifth government) has already survived longer than its recent predecessors, but it faces an uncertain future. The failure of its austerity program or a misstep on the volatile INF issue could quickly lead to its fall, although its successor would probably have the same political coloring. [REDACTED]

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The Political Situation

The Martens coalition demanded and got "special powers" to rule by decree in the welfare and economic areas for a full year at the beginning of its term, and it is now contemplating whether to ask parliament to renew the powers which expired on 31 December. The cabinet thus far has weathered revolts from the unions over austerity measures and has imposed relative peace, but the economy and INF basing remain politically sensitive issues. Slower-than-promised progress on unemployment could spark renewed union action, especially in depressed Wallonia. The shaky state of the government-supported Cockerill-Sambre steel company has become another political landmine, pitting some of the French-speaking cabinet members against the Dutch-speaking members in a battle over continued subsidization of the ailing Walloon steelworks. Too hasty an implementation of INF deployment likewise could cut short the government's tenure. If the coalition does fall, political arithmetic and the reluctance of the Socialist opposition to inherit Belgium's many problems suggest that any successor government is likely to have the same political orientation as Martens V. [REDACTED]

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Economic Outlook

Belgium's economic performance has deteriorated steadily, largely because of surging wages and benefits, rising energy prices, and structural difficulties. The growth of wages and social transfers from 62 to 75 percent of value added in industrial production over the last 10 years has contributed to declining profits and investment. Business investment fell by over 8 percent in 1981 while unemployment, government deficits, real growth and inflation all worsened. Little improvement was registered last year; unemployment, currently around 11 percent, continues to rise and inflation remains near double digits. Real GDP growth this year is forecast at roughly 0.5 percent, the same increase as in 1982. [REDACTED]

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Since taking office, the coalition's policy has been directed at redistributing income from households to enterprises in order to encourage investment and revitalize ailing industries. The devaluation of the Belgian franc by 8.5 percent against the other EMS currencies and accompanying austerity moves last March have helped to reduce real wages by the government's 2-percent target. New measures introduced in November 1982 are aimed at maintaining wage controls for two more years, raising \$320 million in new taxes, and cutting working time to create 80,000 more jobs. If successful, the program would reduce the official deficit estimate to 10.2 percent of GDP this year as opposed to 11.4 percent in 1982 and 12.7 percent in 1981. A quasi-official Treasury forecast puts the 1982 deficit at a more realistic 14.2 percent of GDP. 25X1

The foreign sector remains the leading source of growth as exports continue to top imports in volume terms. In 1982, the trade deficit declined by about \$700 million to \$3.9 billion, while the current account showed a smaller improvement, dropping to \$4.9 billion. An economic recovery would raise imports and again widen the deficit, but current projections envisage no significant improvement in growth until at least 1984. 25X1

Foreign Policy Priorities

Although the coalition favors INF basing and has quietly announced a basing site, it is moving ahead slowly and with little publicity to avoid a public outcry. Over one hundred townships in Flanders and the Walloon Regional Council have passed nuclear-free-zone resolutions in one form or another. While not legally binding, these expressions of opposition, combined with a certain ambivalence in Martens' Social Christian party, make the government reluctant to proceed openly. 25X1

Brussels has agreed in principle to provide troops or technical assistance for the multinational force in Lebanon if it is compensated for their cost. It is unlikely to be deterred from continuing its nuclear cooperation with Libya. In other areas, Belgians often see issues from the EC perspective and follow the lead of their larger Community partners. Foreign Minister Tindemans, worried that the US and EC are drifting apart, will probably continue to push for the creation of a ministerial level US-EC forum to thrash out disputes and reach consensus on solutions. 25X1

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Next 3 Page(s) In Document Denied